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INR-07 L-03 NSAE-00 NSC-05 PA-01 PRS-01 SP-02 SS-15
USIA-06 AID-05 COME-00 EB-07 FRB-03 TRSE-00 XMB-02
OPIC-03 CIEP-01 LAB-04 SIL-01 OMB-01 STR-04 CEA-01
FEA-01 /101 W

----- 049074 /70

R 171544Z DEC 76
FM AMEMBASSY ROME
TO SECSTATE WASHDC 1812
INFO USMISSION EC BRUSSELS
AMCONSUL FLORENCE
AMCONSUL MILAN
AMEMBASSY MOSCOW
AMCONSUL NAPLES
AMEMBASSY TRIPOLI
AMCONSUL GENOA
AMCONSUL PALERMO
AMCONSUL TRIESTE
AMCONSUL TURIN

C O N F I D E N T I A L SECTION 1 OF 2 ROME 20487

MILAN HOLD FOR TURIN

E. O. 11652: GDS
TAGS: EFIN, EIND, ECON, PFOR, IT, LT, UR
SUBJ: EMBASSY COMMENTS ON FIAT-LIBYA AGREEMENT

REF: ROME 20322 AND PREVIOUS

SUMMARY. NOW THAT THERE HAS BEEN TIME TO DIGEST PUBLISHED
DETAILS OF FIAT-LIBYA AGREEMENT, FIAT AND LIBYAN PRESS
STATEMENTS AND GENERAL PRESS SPECULATION, EMBASSY BELIEVES
IT IS APPROPRIATE TO OFFER ITS OWN THOUGHTS O THE
AGREEMENT, POSSIBLE SIGNIFICANCE AND IMPLICATIONS AND THE
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MANY UNANSWERED QUESTIONS. IN ESSENCE, EMBASSY BELIEVES
THERE WERE VALID, UNDERSTANDABLE REASONS FOR LIBYAN
INVESTMENT IN FIAT AS WELL AS FOR FIAT TO HAVE ACCEPTED IT.
ON THE OTHER HAND, LIBYAN WILLINGNESS TO HAVE PAID HIGH
PRICE FOR FIAT SHARES LENDS CREDENCE TO SUSPICION THAT
THERE IS MORE TO AGREEMENT THAN MEETS THE EYE, OR

AT LEAST THAN DESIRE FOR MANAGEMENT ROLE. SOVIET CONNECTION IS ALSO SOMEWHAT MURKY. WHILE THERE IS A STRONG POSSIBILITY THAT FIAT-SOVIET RELATIONS FIGURED DIRECTLY IN FIAT'S WILLINGNESS TO ACCEPT LIBYAN PARTNERSHIP, IT SEEMS UNLIKELY THAT SOVIETS ARE IN ANY WAY A DIRECT PARTNER. END SUMMARY.

1. LIBYAN INVESTMENT IN FIAT IS NEAR-PERFECT EXAMPLE OF THE TYPE OF USE OF PETRODOLLARS WHICH WE HAVE BEEN URGING UPON ARAB OIL PRODUCERS, I.E., RATHER THAN USING SURPLUS PETRODOLLARS TO FOMENT REVOLUTION OR SHIFT AMONG SHORT-TERM PLACEMENT OF FUNDS IN EUROPEAN BANKS, LIBYA HAS MADE DIRECT, LONG-TERM INVESTMENT IN A MAJOR INDUSTRY OF A DEVELOPED INDUSTRIALIZED COUNTRY. AN ADDITIONAL PLUS IS FACT THAT INVESTMENT REPRESENTS AN INCREASE IN FIAT'S CAPITAL RATHER THAN PURCHASE OF EXISTING SHARES. THIS INVESTMENT SHOULD SERVE OUR INTERESTS BY GIVING LIBYA A STAKE IN THE DEVELOPED INDUSTRIALIZED WORLD AND THUS TYING TO SOME EXTENT ITS INTERESTS WITH THAT OF THE WESTERN WORLD.

2. FACT THAT LIBYA CHOSE ITALY AS DESTINATION FOR CAPITAL INVESTMENT IS NOT SURPRISING AT ALL. ITALY IS UNDOUBTEDLY THE INDUSTRIALIZED COUNTRY IT KNOWS BEST AND THE ONE WITH WHICH IT HAS HAD THE LONGEST HISTORY OF ECONOMIC (AS WELL AS OTHER) RELATIONS. EVEN THOUGH THIS HAS BEEN BASICALLY A LOVE-HATE RELATIONSHIP, THE FACTORS OF FAMILIARITY AS WELL AS PROXIMITY UNDOUBTEDLY PLAYED AN IMPORTANT ROLE.

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3. APART FROM FINANCIAL/ECONOMIC CONSIDERATION, MOTIVE FOR LIBYAN INVESTMENT WOULD ALSO SEEM TO US TO EXIST FROM TWO SOURCES. FIRST, LARG HAS BECOME INCREASINGLY ISOLATED IN THE MIDDLE EAST AND IT COULD SEE TIE-IN WITH FIAT AS GIVING IT INCREASED RESPECTABILITY AND POLITICAL INFLUENCE (SEE PARA 6). SECONDLY, WHILE THERE UNDOUBTEDLY ARE RATHER TIGHT LIMITS TO LIBYA'S CAPACITY OF ABSORPTION, THIS INVESTMENT COULD PROVIDE MEANS FOR SOME TRANSFER OF TECHNOLOGY AND/OR OTHER ASSISTANCE IN DEVELOPMENT OF LIBYAN INDUSTRIAL CAPACITY.

4. BEYOND THIS POINT, QUESTIONS START TO APPEAR. THE FIRST ONE IS WHY LIBYA AGREED TO PAY 6,000 LIRE PER SHARE, I.E., MORE THAN THREE TIMES THE PRE-AGREEMENT SHARE VALUE ON THE ITALIAN STOCK MARKET. THE REPLY THAT THE AVERAGE PRICE WOULD HAVE RISEN ABOVE LIRE 6,000 IF LIBYA HAD PURCHASED THAT AMOUNT OF SHARES IN THE STOCK MARKET SEEMS VERY WEAK. PARTICULARLY IF CARRIED OUT

OVER A LONG PERIOD OF TIME (AND NEGOTIATIONS REPORTEDLY LASTED 18 MONTHS), IT IS HARD TO BELIEVE THAT THE AVERAGE PRICE WOULD HAVE RISEN SO HIGH. ANOTHER REPLAY IS THAT INDEPENDENT AUDITORS VALUED FIAT SHARES ABOVE LIRE 6,000, PRESUMABLY ON BASIS OF COMPANY'S ASSETS. THIS IS BASICALLY IRRELEVANT BECAUSE (A) IT APPARENTLY DID NOT TAKE INTO ACCOUNT FIAT'S RELATIVELY LOW EARNINGS RATE AND (B) WHY PAY MORE WHEN YOU CAN PAY LESS? PERHAPS MORE PLAUSIBLE IS THE THEORY THAT SUCH A VOLUME OF SHARES WOULD NOT HAVE BEEN OBTAINABLE ON THE STOCK MARKET.

5. BY FAR MOST LIKELY REASON FOR LIBYAN PURCHASE OF NEW SHARES AT LIRE 6,000 WAS COMBINATION OF LIBYAN DESIRE FOR SECRECY PENDING CONCLUSION OF ENTIRE INVESTMENT PACKAGE AND DESIRE FOR PARTICIPATION IN MANAGEMENT OF FIAT. IF LIBYANS HAD SOUGHT TO MAKE PURCHASE ON STOCK MARKET, EVEN ACTING WITH MAXIMUM DISCRETION THROUGH INTERMEDIARIES, SUCH ACTION WOULD VERY LIKELY HAVE BECOME KNOWN TO THE CONFIDENTIAL

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PRESS, AND PUBLICATION OF PRESS REPORTS WOULD IN ALL PROBABILITY HAVE CAUSED LIBYANS TO WITHDRAW. MORE IMPORTANTLY, PURCHASE OF EXISTING STOCK IN THE STOCK MARKET WOULD NOT NECESSARILY ENSURE THEM ANY PARTICIPATION, WHEREAS AGREEMENT WITH FIAT PROVIDED SPECIFICALLY FOR LIBYAN MEMBERSHIP ON BOTH THE BOARD OF DIRECTORS AND THE EXECUTIVE COMMITTEE. THIS IS IN LINE WITH STATEMENT BY LIBYAN BANK OFFICIALS IN ITALIAN PRESS THAT LIBYANS DID NOT INTEND MERELY TO CLIP COUPONS BUT RATHER TO PARTICIPATE IN MANAGEMENT OF FIAT. IT IS NOT CLEAR TO EMBASSY WHETHER PROVISION FOR MANAGEMENT PARTICIPATION IN ITSELF WAS SUFFICIENT JUSTIFICATION FOR PAYMENT OF HIGH PRICE FOR FIAT SHARES OR WHETHER--AS HAS BEEN WIDELY SPECULATED IN THE ITALIAN PRESS--THERE ARE OTHER ARRANGEMENTS OR UNDERSTANDINGS BETWEEN FIAT AND THE LIBYANS WHICH HAVE NOT BEEN MADE PUBLIC.

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6. THE NEXT QUESTION IS WHAT LIBYANS INTEND TO DO WITH THEIR MANAGEMENT ROLE. IN THEIR PRESS INTERVIEWS LIBYAN BANK OFFICIALS INSISTED THAT THEIR SOLE CONCERN WAS THAT OF PROFITABILITY AND PROMOTION OF FIAT'S INTERESTS. WHILE THEY INDICATED, IN RESPONSE TO PRESS QUERIES, THAT THEY WOULD VOTE AGAINST BUT NOT SEEK TO BLOCK AN EVENTUAL FIAT INVESTMENT IN ISRAEL, IT SEEMS QUESTIONABLE THAT THEY WOULD IN FACT TAKE SUCH A RELAXED, NON-POLITICAL ATTITUDE. THE TENTIAL LIBYAN ABILITY TO INFLUENCE FIAT OPERATIONS SEEMS TO BE CONSIDERABLE. ALTHOUGH THE AGNELLI FAMILY AND OTHER ITALIAN INTERESTS CLOSELY RELATED TO IT UNDOUBTEDLY ARE MATHEMATICALLY ABLE TO ENSURE THAT FIAT IS RUN ACCORDING TO THE FAMILY'S CONFIDENTIAL

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WISHES, IT IS HARD TO BELIEVE THAT THE SECOND LARGEST SINGLE SHAREHOLDER, CONTROLLING ABOUT 10 PERCENT OF FIAT, COULD NOT HAVE STRONG VOICE IN OPERATION OF THE COMPANY. IN WHAT AREAS MIGHT LIBYANS SEEK TO CHANGE FIAT POLICIES OR DECISIONS? WHILE THIS IS ALL IN REALM OF SPECULATION, WE WOULD SEE AS POSSIBILITIES (A) DESPITE STATEMENTS QUOTED ABOVE, REDUCTION OR ELIMINATION OF COMMERCIAL RELATIONS WITH ISRAEL: AND/OR (B) CONVERSELY ESTABLISHMENT OR INCREASE IN RELATIONS WITH COUNTRIES IN ACCORDANCE WITH LIBYAN POLITICAL INTERESTS RATHER THAN ECONOMIC FACTORS. THIS WOULD BE PARTICULARLY THE CASE WITH MILITARY AND MILITARY-RELATED PRODUCTION OF FIAT, E.G., AIRCRAFT ENGINES, TANKS, TURBINES, SHIPS' ENGINES, ETC. FINALLY, IF THERE IS INDEED UNPUBLISHED

AGREEMENT OR UNDERSTANDING BETWEEN LIBYA AND FIAT, MEMBERSHIP ON BOARD OF DIRECTORS AND EXECUTIVE COMMITTEE WOULD GIVE LIBYANS DIRECT OVERSIGHT CAPACITY.

7. FINALLY, THERE IS THE QUESTION OF LA STAMPA, ONE OF ITALY'S LEADING DAILY NEWSPAPERS, WHICH IS OWNED BY FIAT AND WHOSE EDITOR (ARRIGO LEVI) IS JEWISH. QADHAFI SOUGHT UNSUCCESSFULLY TO HAVE LEVI FIRED COUPLE OF YEARS AGO BECAUSE OF CRITICAL ARTICLES PUBLISHED BY LA STAMPA. ALTHOUGH AGNELLI HAS PUBLICLY ASSERTED THAT FIAT WOULD NOT INTERFERE IN THE OPERATIONS OF LA STAMPA AND LIBYAN BANKERS HAVE PUBLICLY STATED THAT THEIR INTEREST IN LA STAMPA WOULD BE CONNECTED TO THE QUESTION OF PROFITS AND BENEFITS TO FIAT, IT CANNOT BE EXCLUDED THAT LARG WOULD INTEREST ITSELF IN LA STAMPA. SINCE LA STAMPA HAS BEEN LOSING MONEY STEADILY (AS HAVE MOST ITALIAN NEWSPAPERS), THE LIBYANS COULD VERY WELL SEEK TO EFFECT CHANGES IN LA STAMPA FOR THEIR OWN POLITICAL REASONS BUT WITH ECONOMIC JUSTIFICATIONS.

8. THE OTHER DIMENSION TO LIBYA-FIAT AGREEMENT IS THE SOVIET UNION, WHICH ENTERED THE SCENE WITH FIAT
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PRESIDENT AGNELLI'S SUDDEN TRIP TO MOSCOW TO MEET WITH QADHAFI. THERE SEEMS TO BE LITTLE DOUBT THAT QADHAFI ASKED AGNELLI TO MEET HIM IN MOSCOW DURING HIS STATE VISIT AND AGNELLI AGREED. IF THERE HAD BEEN ANY OTHER REASON--OR EVEN PLAUSIBLE EXCUSE--AGNELLI WOULD PRESUMABLY HAVE USED IT RATHER THAN ASSERTING BLANDLY THAT IT WAS LOGICAL TO MEET QADHAFI ON "NEUTRAL" GROUND. EVEN IF THE MEETING WERE "TOTALLY INNOCENT," FROM A PUBLIC RELATIONS STANDPOINT IT CAN ONLY GIVE RISE TO SPECULATION THAT LIBYA'S NEW INFLUENCE IN FIAT WAS SUCH THAT A PEREMPTORY SUMMONS FROM QADHAFI WAS ALL THAT WAS REQUIRED TO MAKE AGNELLI COME RUNNING.

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9. THE THEORY THAT THE SOVIET UNION SERVED AS "MARRIAGE BROKER" SEEMS HIGHLY UNLIKELY. IN THE FIRST PLACE, LIBYAN-SOVIET RELATIONS WERE COOL AT THE TIME LIBYA-FIAT NEGOTIATIONS BEGAN AND SECONDLY IT IS HARD TO IMAGINE WHY THE TWO PARTIES DIRECTLY CONCERNED COULD NOT GET TOGETHER WITHOUT BENEFIT OF AN INTERMEDIARY.

10. MORE INTERESTING, HOWEVER, IS THE QUESTION OF WHETHER THE SOVIET UNION HAS A DIRECT COMMERCIAL INTEREST IN THE ARRANGEMENT. FIAT HAS IMPORTANT BUSINESS INTERESTS IN THE SOVIET UNION AND HAS BEEN ANXIOUS TO EXPAND THESE, WHILE AT THE SAME TIME GOI HAS BEEN RELUCTANT TO EXTEND NEW CREDITS TO THE SOVIET UNION. AGNELLI'S REPLIES TO

PRESS INQUIRIES ON POSSIBLE SOVIET LINK HAVE BEEN AMBIGUOUS. FOR EXAMPLE, HIS STATEMENT THAT THE DOLS 104 MILLION LIBYAN LOAN (WHICH WILL NOT BE USED IN ITALY BECAUSE THE BANK OF ITALY WILL NOT GUARANTEE THE FOREIGN EXCHANGE RISK) WILL NOT BE USED IN EAST EUROPE IS LARGELY IRRELEVANT. WHILE UNDOUBTEDLY TECHNICALLY CORRECT, IT BEGS THE QUESTION OF WHETHER INCREASE IN FIAT'S FINANCIAL CAPABILITIES WILL BE USED TO EXPAND OR OTHERWISE PROMOTE ITS ACTIVITIES IN SOVIET UNION.

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11. FINAL QUESTION IS THAT OF AGNELLI'S MOTIVES IN ENTERING INTO THE AGREEMENT WITH LIBYANS. FINANCIAL ADVANTAGES TO FIAT ARE OBVIOUS, AND THESE OBVIOUSLY OUT-WEIGHED ANY DISTASTE OR CONCERN HE MIGHT HAVE HAD ABOUT ACQUIRING QADHAFI AS A PARTNER. SOME HAVE LINKED AGREEMENT WITH FREQUENTLY-REPEATED CHARGES THAT AGNELLI IS SHIFTING HIS INTERESTS OUT OF ITALY SO AS TO HAVE PROTECTION AGAINST THE DAY WHEN FIAT MIGHT BE NATIONALIZED OR WHEN FOR WHATEVER REASON HE DECIDED TO LEAVE ITALY-- A CHARGE, INCIDENTALLY, WHICH AGNELLI HAS STOUTLY DENIED. WHILE IT IS DIFFICULT TO PIN DOWN EXTENT OF "WITHDRAWAL" BY AGNELLI FROM ITALY, OR INDEED WHAT THAT TERM REALLY MEANS, FACT IS THAT FIAT'S OPERATIONS OUTSIDE ITALY HAVE EXPANDED CONSIDERABLY IN RECENT YEARS-- A TREND WHICH CAN BE INTERPRETED VARIOUSLY AS REPRESENTING FIAT'S TAKING ADVANTAGE OF BUSINESS OPPORTUNITIES REDOUNDING TO COMPANY'S ADVANTAGE OR AS REPRESENTING "AGNELLI GETTING HIS MONEY OUT OF ITALY." ONE CLEAR ADVANTAGE LIBYAN PARTNERSHIP WILL BRING HIM IS INCREASED INDEPENDENCE FROM DOMESTIC SOURCES OF FINANCING, WHICH IN TURN IMPLIES MORE FREEDOM FROM DOMESTIC POLITICAL PRESSURES. BEAUDRY

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Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: REPORTS, AGREEMENTS, AUTOMOTIVE INDUSTRY, INTELLIGENCE ASSESSMENTS, FOREIGN INVESTMENTS, FINANCIAL PROGRAMS
Control Number: n/a
Copy: SINGLE
Draft Date: 17 DEC 1976
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: ElyME
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1976ROME20487
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Film Number: D760465-0334
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Legacy Key: link1976/newtext/t19761233/aaaabbxh.tel
Line Count: 314
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION EUR
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 6
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: 76 ROME 20322
Review Action: RELEASED, APPROVED
Review Authority: ElyME
Review Comment: n/a
Review Content Flags:
Review Date: 06 APR 2004
Review Event:
Review Exemptions: n/a
Review History: RELEASED <06 APR 2004 by ShawDG>; APPROVED <06 AUG 2004 by ElyME>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
04 MAY 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: EMBASSY COMMENTS ON FIAT-LIBYA AGREEMENT
TAGS: EFIN, EIND, ECON, PFOR, IT, LT, UR, FIAT
To: STATE
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 04 MAY 2006